



# Facilitation of Withholding Tax and Securities Transfer Tax

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## Key Take-aways

- 1.** The abolition of withholding tax on interest payments on bonds will facilitate Swiss borrowing because transfer restrictions will no longer apply and an unlimited use of proceeds will be possible.
- 2.** Swiss group financing activities are encouraged, as customer balances of legal entities are no longer subject to withholding tax.
- 3.** The abolition of securities transfer tax on trading in domestic bonds, on the transfer of participations and on money market funds complete the package of measures.

## 1 Introduction

On 17 December 2021, the Swiss Parliament passed an **amendment to the Federal Withholding Tax Act**, against which a referendum has been filed and which is expected to be voted on in autumn. On the one hand, the revision intends to strengthen the Swiss debt capital market. On the other hand, it aims to create attractive tax rules for group financing activities in order to promote Switzerland as a location for holding companies. This marks the preliminary end of many years of attempts to reform the withholding tax law. However, the legislator decided not to undertake a fundamental reform by introducing a paying agent tax and the associated change from the debtor to the paying agent principle.

The **main change** is the abolition of withholding tax on interest payments on bonds (para. 2). However, in order to avoid major tax losses, only so-called new issuances are to benefit from the abolition. In addition, the revision contains further changes (para. 3). Finally, certain provisions in the securities transfer tax law will be amended (para. 4).

## 2 Abolition of Withholding Tax on Interest Payments on Bonds

### 2.1 Facilitation in Relation to Credit Agreements

Interest payments on bonds issued by a Swiss resident are currently subject to a withholding tax of 35%. It should be noted that the terms "resident" and "bond" are tax terms, which has two consequences: On the one hand, **loans** (especially syndicated loans) may be **reclassified as bonds or debentures** for withholding tax purposes. Consequently, interest payments by a Swiss debtor on such loans become subject to withholding tax. On the other hand, foreign issuances guaranteed by a Swiss company are considered as domestic issuances for withholding tax purposes, provided that the funds raised abroad are to a certain extent directly or indirectly **used in Switzerland**.

The abolishment of withholding tax on interest payments on bonds as of 1 January 2023 eliminates the existing risk that loans could be reclassified as bonds or debentures subject to withholding tax if a certain number of so-called non-bank creditors is exceeded. This will allow to **dispense with the inclusion of the so-called 10/20 non-bank rules** in the future, which were sometimes difficult to convey to foreign parties. The associated transfer restrictions and the recalculation of interest clause will also no longer be necessary. Further, the **restrictions on the use of proceeds** required for domestically guaranteed foreign issuances will also become obsolete.

As a **transitional rule**, it is envisaged that interest payments on bonds formally issued by a Swiss resident before 1 January 2023 will continue to be subject to withholding tax. Existing Swiss issuances will therefore not benefit from the new legislation. However, due to the formal concept of the notion Swiss resident, it will be possible to repatriate existing foreign issuances after 1 January 2023 by transferring the foreign issuer's registered office to Switzerland or to refinance them by replacing the foreign issuance with a domestic one. The previous restrictions on the use of proceeds in the case of

domestically guaranteed foreign issuances will become obsolete when the amendment enters into force, since the issuance is made through a formally foreign issuer and is therefore not covered by the transitional rule.

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## Future credit agreements without 10/20 non-bank rules.

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### 2.2 Structured Products

The abolition of withholding tax on interest payments on bonds also increases the attractiveness of certain **structured products launched by Swiss issuers**. Specifically, this applies to those products with a bond component (e.g. reverse convertibles). If these are issued by a Swiss issuer, the interest component of the payment is currently subject to withholding tax. This will no longer be the case after the revision. Since the variety of structured products is almost infinite, but the withholding tax will only be abolished on interest payments on bonds, it will be necessary to carefully examine which components the income payment of the product in question is composed of and whether these are subject to withholding tax.

## 3 Further Changes

### 3.1 Collective Investment Schemes

**Distributions from Swiss Collective Investment Schemes** are in principle also subject to withholding tax. This even applies to foreign collective investment schemes if their units were issued in conjunction with a Swiss resident. The fact that distributions from Swiss collective investment schemes are subject to withholding tax has always been criticised and seen as a disadvantage for the Swiss fund industry. Accordingly, there have been longstanding calls for the abolition of withholding tax on distributions from collective investment schemes as well. This demand was not considered by the legislator. However, distributions of income from bonds and serial promissory notes on a separate coupon will no longer be subject to withholding tax. This adds a further exemption to the one that already exists for capital gains, income from direct real estate investments and the repayment of investors' capital contributions.

### 3.2 Customer Balances with Domestic Banks and Insurance Companies

So far, payments on customer balances at Swiss banks and savings banks have been subject to withholding tax. In future, only income on customer balances of **resident individuals** at regulated domestic banks and insurance companies will be subject to withholding tax. In order to be subject to withholding tax, the individual must be resident in Switzerland and the bank must be subject to the Federal Banking Act or the insurance company must be subject to the Federal Insurance Act.

Payments on customer balances of legal entities and foreign individuals will no longer be subject to withholding tax, which means that the current 100 non-banks rule will also cease to apply. This should significantly simplify cash pooling and thus group financing activities out of Switzerland.

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## Unlimited use of proceeds in Switzerland in case of foreign issuances.

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### 3.3 Manufactured Payments

Certain transactions with securities over the dividend due date can be abused to obtain a **double withholding tax refund**. This applies in particular to securities lending and borrowing transactions. In order to prevent such abuses, the Federal Tax Administration and the Swiss Bankers Association had a *gentleman's agreement* to levy a **voluntary withholding tax** on manufactured payments in the context of securities lending and borrowing transactions. This voluntary levying of withholding tax on manufactured payments was a requirement for the borrower, as the formal owner of the securities, to be able to reclaim the withholding tax levied on the original payment made to him.

In its decision of 21 November 2017, the Federal Supreme Court ruled that levying withholding tax on manufactured payments **lacked a legal basis**. This questioned the practice that had been accepted and proven by all parties involved for decades and led to uncertainty in the market. In order to correct this decision, a **new legal basis** for levying withholding tax on manufactured payments will be **created**. As a result, in addition to domestic debtors, foreign debtors will also be obliged to levy withholding tax on manufactured payments – in full awareness that a tax collection abroad cannot be enforced. Nevertheless, this obligation will put foreign banks in an inconvenient position, as they will be in breach of Swiss law if they fail to comply, which could have negative consequences both in Switzerland as well as abroad and could result in reputational damage.

## 4 Facilitation of Securities Transfer Tax

### 4.1 Secondary market transactions with Swiss bonds

Primary market transactions with Swiss bonds, i.e. issuance and redemption, are already exempt from securities transfer tax under the current law. In addition to these existing exemptions, **secondary market transactions with Swiss bonds** shall also be exempt from securities transfer tax in future. As a result, the previously payable securities transfer tax of up to 0.15% on secondary market transactions with Swiss bonds will be abolished completely. In contrast, secondary market trans-

actions with **foreign** bonds will remain subject to securities transfer tax of up to 0.3%. However, this only applies if buyer and seller are domestic parties. This is because foreign parties are already exempt from securities transfer tax on secondary market transactions with foreign bonds under the current law.

### 4.2 Transfer of Participations

Swiss corporations and cooperatives as well as Swiss pension funds that have taxable securities with a book value of more than CHF 10 million on their balance sheet qualify as securities dealers for securities transfer tax purposes pursuant to Article 13(3)(d) of the Federal Stamp Duty Act (FSDA). Besides Swiss pension funds, Swiss holding companies are particularly affected by this provision. As a result, they regularly become liable for securities transfer tax on the purchase and sale of their investments.

The brokerage as well as the sale and purchase of Swiss or foreign shareholdings of at least 10% of the nominal capital of other companies by such securities dealers according to Article 13(3)(d) FSDA is now to be **exempt**, provided that the shareholding is deemed to be a **fixed asset** pursuant to Article 960d of the Swiss Code of Obligations. This newly created exemption applies not only among third parties, but also within group companies. This should facilitate group-internal reorganisations in the future.

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## Trading in domestic bonds free of securities transfer tax.

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### 4.3 Money Market Funds

Money market funds are funds that invest in money market instruments, i.e. bonds with a term of less than twelve months. Neither the issuance nor the redemption of money market instruments is subject to securities transfer tax. Likewise, trading in money market instruments is not subject to securities transfer tax. Thus, money market instruments are completely exempt from the securities transfer tax.

The situation is different for an indirect investment in money market instruments via money market funds. Under current law, only the issuance of units in Swiss collective investment schemes is exempt from securities transfer tax. The issuance of units in foreign money market funds, on the other hand, is subject to securities transfer tax.

In future, both **the issuance and the redemption of units of foreign money market funds** will be **exempt from securities transfer tax**, provided that the money market funds invest exclusively in securities with a (remaining) term to maturity of no more than 397 days (final maturity date). This change should increase the attractiveness of Switzerland as a location for treasury companies or holding companies with a treasury function.

## 5 Conclusion

The envisaged withholding tax and securities transfer tax facilitations will not miss their target. Until now, the withholding tax hung like the sword of Damocles over borrowings with the participation of a Swiss company, which required the inclusion of transfer restrictions. For borrowings after 1 January 2023, these so-called 10/20 non-bank rules will no longer be necessary. At the same time, existing foreign issuances can be repatriated to Switzerland or refinanced via Switzerland without being subject to withholding tax in the future. The previous

restrictions on the use of proceeds in Switzerland will also be abolished. Together with the abolition of the securities transfer tax on domestic bonds, the Swiss debt capital market will be strengthened.

Furthermore, the facilitations should also strengthen the Swiss holding location, as the abolition of withholding tax on customer balances of legal entities as well as the abolition of the securities transfer tax on the issuance and redemption of units of foreign money market funds will make intra-group financing (e.g. cash pooling and treasury) via Swiss group companies more attractive.



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